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PROBABLE ECONOMIC DEVELOPMENTS IN YUGOSLAVIA

IV. Conclusions: Yugoslavia's Problem of Adjustment

- A. IBRD Estimate of Yugoslav Balance of Payments in 1955-56
- B. Analysis of the IBRD Projection
- C. Outlook Through 1955-56

S-E-C-R-E-T

PROBABLE ECONOMIC DEVELOPMENTS IN YUGOSLAVIA

IV. Conclusions: Yugoslavia's Problem of Adjustment

Conclusions regarding Yugoslavia's ability to adjust to eventual withdrawal of foreign economic aid and the debt servicing burden must, by necessity, be of a tentative nature. In order to arrive at an answer to the question of whether Yugoslavia can achieve a balance in its foreign economic transactions without external aid in any one year, it is necessary to make a number of "heroic" assumptions, any one of which could prove faulty. In section A below, an estimated balance of payments prepared by the staff of the IBRD for fiscal year 1955-56^{1/} is presented, together with the explicit and implicit assumptions on which it is based. The remainder of section IV attempts to draw conclusions based on data and analysis in sections I, II, and III of this study. Section B provides an analysis of the IBRD presentation, while section C examines the various possibilities for the solution of Yugoslavia's foreign economic problems in the near future.

A. IBRD Estimate of Yugoslav Balance of Payments in 1955-56

The IBRD balance of payments was chosen for this study as it is the latest useable estimate available at this time.^{2/} This estimate was made for the purpose of determining the effects of the proposed IBRD loan on the Yugoslav investment program and the ability of Yugoslavia to service the

^{1/} "Economic Developments and Creditworthiness of Yugoslavia," IBRD, January 30, 1953.

^{2/} Embassy Belgrade has recently completed a detailed study of the Yugoslav investment program and the probable effect it will have on the Yugoslav balance of payments. Unfortunately, as of the beginning of October, this study was not available in Washington and could not be used to supplement the data presented by the IBRD.

loan. The basic data in the estimate can also be used, however, for the different purpose of determining the likelihood of the achievement of a balance in Yugoslav foreign economic transactions in the near future.

There is available a recent Yugoslav estimate of the prospective balance of payments in 1953-54 and 1954-55, but it is based on two apparently unwarranted assumptions: The first is that additional foreign aid amounting to about \$88 million would be granted to Yugoslavia in fiscal year 1953-54 in addition to the \$75 million of aid shipments expected in that year, for a total of \$163 million, much larger than grant aid in any previous year. The other assumption, appearing to be even more unrealistic, is that given this greater level of aid in 1953-54 the Yugoslav balance of payments in 1954-55 would be neatly balanced without any further foreign aid. The most unrealistic element in the Yugoslav projection is the estimate that industrial output in fiscal year 1954-55 would be 34 percent over the calendar year 1952 level, and exports of industrial goods would increase by 37 percent over 1952. As indicated below, this is considerably more optimistic than the IBRD estimate; in addition there is no explanation for the supposition that exports would increase at a more rapid rate than production.

The IBRD estimate of the Yugoslav balance of payments in 1955-56 and comparable data for previous years are presented in Table IVA-1.

Table IVA-1. Balance of Payments, IBRD Estimate for 1955-56 and
Comparable Data for Previous Years

(In millions of US dollars in current prices)

	<u>1951-52</u>	<u>1952-53</u>	<u>1953-54</u>	<u>1955-56</u>
Exports	264	183	237	250
Imports	<u>361</u>	<u>408</u>	<u>330</u>	<u>230</u>
Trade balance	-97	-225	-93	+20
Net invisibles <u>a/</u>	+9	+8	+9	+10-15
Debt service <u>b/</u>	40	30	30	30-35

a/ This item represents the net balance of services from 1951-54. The IBRD report does not make clear what it represents in 1955-56; it is presumed to represent the net balance of services in that year, too.

b/ This item represents actual debt service payments in 1951-52, estimated payments in 1952-53 and 1953-54, and amount available for debt service in 1955-56. It should be noted that in 1955-56 it is the residual item.

Sources: 1951-54--Annex I, Table 6, (1951-52 is actual, 1952-53 and 1953-54 are FOA estimates), 1955-56--IBRD projection from "Current Economic Developments and Creditworthiness of Yugoslavia," IBRD, January 30, 1953.

In arriving at these estimates numerous assumptions were made by the IBRD staff. Listed below are seven assumptions that were explicitly mentioned in the IBRD report:

1. No major new investment program requiring large amounts of imported capital goods would be undertaken after expected completion of the major portion of the key investment program in 1955. Thus, only \$50 million of capital goods imports are included as compared to about \$100 million in 1951-52.

2. The completion of the key investment projects by 1955 would result in an increase in industrial production in 1955-56 by 30 percent or more over the 1951 level.

S-E-C-R-E-T

3. Yugoslav grain production would approximate 110 percent of the 1947-51 average, assuming normal weather conditions.

4. Prices of Yugoslav export goods are assumed 10 percent below their level in first half of 1952; prices of imports, 5 percent below their level in the same period. Thus, in current prices, total exports would decrease by \$14 million; and total imports, by \$131 million under 1951-52, as indicated in Table IVA-1.

5. Total exports, in comparable prices, are assumed at 7 percent over the 1951-52 level (food exports at only 81 percent of this level, non-food exports at 129 percent). In terms of prices prevailing in the first half of 1952, exports are estimated at \$278 million in 1955-56, as compared to \$259 million in 1951-52.

6. Non-capital goods imports are estimated at \$65 million below the 1951-52 level in comparable prices.

7. \$30 to \$35 million would be sufficient to cover Yugoslavia's debt-servicing needs in 1955-56.

There was also one implicit assumption and one omission that are of the utmost importance.

It is implicitly assumed that the Yugoslav Government's plans are based on the premise that no foreign economic aid would be forthcoming in 1955-56 even if its programs should result in new deficits in the Yugoslav trade balance. The very significant omission is the exclusion of the impact of the MDAP support needs from the estimated balance of payments.

-14-

S-E-C-R-E-T

B. Analysis of the IBRD Projection

1. General Comments

The Staff of the IBRD is unquestionably professionally qualified to make an estimate of this type and is presumed not to be prejudiced in any way. There was, however, great political pressure on the IBRD to extend a second loan to Yugoslavia and it is at least conceivable that this may have influenced somewhat the choice of assumptions that were made. This point should not be overemphasized as the analysis of the IBRD projection reveals that it is, in general, a conservative estimate. Although the projection was made at the beginning of 1953, there does not appear to have been any development that would change significantly the objective conditions underlying the estimate. There are, of course, so many variables and unknowns in any estimate of a country's balance of payments position a few years hence that it is impossible to come to any firm conclusions. The best that can be done is to attempt to base the estimate on assumptions that are as realistic and logical as possible.

The specific assumptions made by the IBRD staff can be conveniently divided into two types. The first concerns the policies of the Yugoslav Government; it includes the Yugoslav thinking on the willingness of the Western powers to continue economic aid and the government's policy on future investment programs. The second type of assumption deals with changes in specific production and foreign trade expectations of various sectors of the Yugoslav economy, which depend on technological, climatic and other factors, as well as government policies.

2. Yugoslav Expectations Regarding Foreign Aid

Probably the most basic assumption that was made by the IBRD was the

implicit one that the Yugoslav Government's plans are based on the premise that no foreign economic aid would be forthcoming in 1955-56 even if its programs should result in new deficits in the Yugoslav trade balance. This point is essential to any discussion of future balance of payments positions, as it is clear that the Yugoslav Government would not hesitate to allow its imports to exceed exports if it believed that the Western powers would bail Yugoslavia out of the resulting difficulties. Some activities of the Yugoslav Government seem to indicate that it is attempting to obtain as much foreign economic aid as it can. In June 1953, the US Embassy in Belgrade was approached by Yugoslav officials and presented with a plan which purported to show that if considerable aid, in addition to that presently planned, were extended in 1953-54, Yugoslav foreign accounts would achieve a balance in 1954-55. As mentioned in section A above, this plan is not realistic as it assumes a greater increase in industrial production in 1954-55 before all the key investment projects are completed than the IBRD considers likely in 1955-56 after the completion of the major part of these projects. Although this may be merely another example of Yugoslav optimism regarding their economic prospects, it may also represent a maneuver aimed at obtaining additional aid.

The Yugoslav leaders' desire to industrialize the country in as short a period as possible would tend to make them hesitate to reduce the level of imports for investment purposes if they can possibly avoid it as indicated in section IID. Recent government statements indicate that the level of investments would not be reduced, but that allocations of investment to various sectors would be altered, thus reducing the need

for imported capital goods. In view of the Yugoslavs' preference for dramatic achievements as opposed to gradual changes, the danger exists that even the investments in agriculture and consumer goods industries might be channeled to a large extent into large-scale projects requiring great quantities of imported capital goods, rather than into small projects which could be equipped by domestic industry.

On the other hand, the various government measures grouped under the title "New Economic System" (see section III and Annex III) appear to be aimed, in part at least, at improving the Yugoslav balance of payments situation. The market policies, which by partly freeing prices allowed them to approach world market prices more closely, and foreign exchange policies, which try to encourage exports and discourage imports, have a direct influence on the balance of payments. The fiscal and credit policies of the Yugoslav Government have a less, but equally important influence on the status of Yugoslav foreign economic transactions. The whole program appears to be aimed at raising productivity by increasing incentives and decreasing administrative interference. All these measures are in a constant state of flux, and no definite conclusions can be reached at this time regarding their effectiveness in assisting Yugoslavia's adjustment.

While there is serious doubt about the attitude of the Yugoslav Government regarding the likelihood of future foreign economic aid, the IBRD staff had no choice but to assume that the Yugoslav Government would undertake all necessary measures to balance its foreign accounts. Unless this basic assumption is made, no projected balance of payments could be derived. This assumption underlies the rest of our discussion, and this

fact must be borne in mind in reading the following analysis.

3. Investment Program

The expectation that no major new investment program would be begun when the key investment program is completed follows from the assumption that the Yugoslav Government believes that the West would not cover its trade deficits any longer, and that all imports would have to be covered out of its own resources. Under these circumstances, the reduction of capital goods imports from about \$100 million in 1951-52 to only \$50 million in 1955-56 would appear reasonable.

4. MDAP Support Problem

The tacit exclusion of MDAP support needs from the balance of payments projection is a most important omission. The IBRD staff does not have at its disposal sufficient information to make any estimates of the magnitude of this item. Nevertheless, the imports required for replacements, spares, and fuel which are needed to make full use of equipment delivered to Yugoslavia under the MDAP program must be considered in any balance of payments projection as they are of sufficient size to be extremely significant and are gradually rising as more MDAP equipment is delivered. The estimate of the support needs in fiscal year 1954-55 derived by the Military Assistance Mission (MAS) to Yugoslavia places them at about \$90 million for domestic and imported goods. (See section IIA.) While this estimate appears very high, and is twice as high as a previous estimate by the same group, there is as yet no basis for making an independent estimate. To suggest the rough order of magnitude of the problem, it might be assumed that the support needs for 1954-55 are half-way between the two estimates, say \$65 million, and the increase between 1954-55 and

1955-56 might be assumed at \$10 million. Assuming further that about 75 percent of this amount would be required for imports (80 percent of the estimated support needs are for spares and replacements, most of which could probably not be produced domestically in Yugoslavia in the near future, while 20 percent is for fuel and ammunition about half of which might be supplied domestically), we arrive at a conservative estimate of about \$50 million of imports required to support the MDAP program in 1955-56. Thus, the conclusion appears inevitable that Yugoslavia would not be able to achieve a balance in its foreign financial transactions under the assumptions underlying the IBRD projection. Furthermore, support needs are not expected to reach their peak until after 1957, so the problem is not merely of a short-term nature.

5. Production and the Foreign Trade Balance

The IBRD assumptions that industrial production would rise to about 30 percent over the 1951 level and grain production to about 110 percent of the 1947-51 average, under normal weather conditions, appear reasonable. If the majority of the key investment projects are completed by the middle of 1955, as expected, an increase in industrial production of 30 percent could easily result, as long as imports of raw materials permit consumer goods industries to operate at no less than 1951 levels. A level of grain production of 110 percent of 1947-51 would not require significant increases in crop yields as it would approximate the 1951 level and be lower than the estimated 1953 crop. The estimate of food exports at 81 percent of the 1951-52 level appears conservative (see Annex IIC). The expectation that, in comparable prices, non-food exports would increase

by 29 percent while total imports were being reduced by about 30 percent from 1951-52 levels may be somewhat optimistic. However, as most of the increase in exports is expected to be in metals and ores, for which there is likely to be a demand in Western Europe (Yugoslavia is one of the major sources of non-ferrous metals outside the dollar area) the increase of 29 percent may not be a significant overstatement. The estimate of a decrease in imports of \$112 million, in comparable prices, depends on the assumption regarding government policies in the fields of investment (\$47 million of this is to be a decrease in capital goods imports) and personal consumption (about \$25 million of the reduction is to result from reduced wheat and lard imports and no increase in imports of textile raw materials). The remaining \$40 million decrease depends on the success of the newly created Yugoslav industry in replacing imports, especially of metal products. The 30 percent reduction in imports assumed by the IBRD is rather drastic and it appears to run counter to the stated policy of the Yugoslav Government to increase living standards. This is especially true of the assumption that there would be no increase in imports of textiles and leather. The substitution of raw cotton and wool imports for yarns and fabrics, which are more expensive, would permit a slight increase in imports of these raw materials without any addition in expenditures. But under normal circumstances, some further increase in these imports should probably have been included in the balance of payments projection to take into account population growth of about half a million from the end of 1953 to the end of 1955, as well as to make provisions for a slight increase in the standard of living of the Yugoslav population.

The expectation that prices of export goods would be 10 percent below the level prevailing in the first half of 1952, while import prices would fall by only 5 percent appears reasonable. From the first five months of 1952 to the same period in 1953, export prices actually fell 14 percent for agricultural products and 22 percent for industrial products, while import prices fell 11 percent,^{1/} approximating the relative movement assumed by the IBRD. There is no assurance, of course, that price movements may not vary considerably from this assumption in the future, but there is no basis for calculating a better estimate than that presented by the IBRD.

6. Debt Servicing

The assumption that \$30 to \$35 million would be sufficient to cover the debt-servicing burden in 1955-56 might be over-optimistic. According to present contractual arrangements Yugoslavia is to repay about \$40 million on loans, credits, and nationalization debts in that year (see section IB). It is estimated that an additional \$12 million would be required to reduce swing credit balances. In addition, if certain loan repayments due in 1953-54 and 1954-55 are postponed temporarily, some of the repayments may become due in 1955-56 and the debt-servicing burden in that year might then be even greater than the \$50 million or so under present arrangements. On the other hand, if some important loans were funded before 1955-56 and loan repayments postponed until after that year, the burden in 1955-56 would be considerably reduced. The effect of any

^{1/} "Izvestaj Odbora za Privredu Saveznog Izvrnog Veka o Razvoju Privrede U I Polugodju 1953, God." (Report on Development of Economy in First Half of 1953) Belgrade 1953.

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C. Outlook Through 1955-56

1. Likelihood of Deficits

Yugoslavia has had a negative balance of trade and services in every postwar year as opposed to positive balances in the prewar period, as indicated in Table IVA-1, and Annex 1, Table 6. In the estimated balance for 1953-54 the deficit in the balance of trade and services is expected to be about \$85 million, and almost 90 percent of it is to be covered by foreign aid. It is very difficult to calculate an estimated balance of payments for the following year, 1954-55, as key investment projects will still be in the process of completion, while it is expected that by 1955-56 almost all of them would be contributing to Yugoslav production and exports. If an estimated balance of payments for 1954-55 were to be calculated in the same manner as the IBRD projection for 1955-56, it is very likely that it would show a negative balance of trade and services of the rough order of magnitude of \$10 to \$30 million excluding MDAP support needs. Since debt servicing charges in 1954-55, according to present contractual arrangements, are equal to about \$70 million, or \$30 million more than in 1955-56, plus an estimated \$12 million for swing reductions, it would seem that 1954-55 will be a very difficult year for the Yugoslav economy unless it receives some aid. The possibility that the good 1953 harvest might permit Yugoslavia to build up inventories and that some of the aid granted in 1953-54 may be utilized in the following year would tend to make the situation/less difficult, but neither of these factors would be nearly sufficient to counterbalance the expected deficit.

It seems quite clear that Yugoslavia will be faced with sizeable trade deficits in both 1954-55 and 1955-56 as long as MDAP support needs are to be paid for by Yugoslav exports. It is possible that a small deficit may exist in 1955-56 even if Yugoslavia does not have to pay for MDAP support needs. As indicated in the previous section, this may be due to the fact IBRD forecasts of increases in non-agricultural exports, decreases of non-capital imports, and debt servicing payments might be slightly too optimistic.

2. Possibilities of "Assistance" Other Than Grant Aid

If these deficits do materialize, there are two types of foreign "assistance" other than grant aid that might be used to help cover the deficits.

a. The first of these is the receipt of new loans from foreign governments, international institutions and private foreign sources. While loans are not assistance in the same sense as grant aid, since they must be repaid at some time, they would relieve much of the short term pressure on Yugoslav foreign exchange resources. Thus, in the short term they serve the same purpose as grant aid in permitting imports to exceed exports. It is not possible to estimate the amount of loans that Yugoslavia could obtain in the next two years, however, even if they were contracted at a rate considerably lower than that prevailing in recent years an average of approximately million \$40/each half year beginning in 1951 they would be of the utmost importance in covering a trade deficit or permitting repayments on old debts.

As indicated in section IB, the Yugoslav Government is likely to make serious efforts to obtain as many loans as possible. This effort would not necessarily run counter to Yugoslav obligations to the IBRD. Total

Yugoslav foreign indebtedness has not reached the \$380 million limit set by the IBRD, and each time principal repayments are made they reduce the level of total indebtedness.

The desirability in the long term view, of increasing the Yugoslav foreign indebtedness depends on the purpose of the loan, the repayment terms, and the future prospects of Yugoslavia. According to present contractual arrangements, debt repayments are to reach a peak in 1954-55 of \$70 million plus \$13 million in swing reductions and then decline rapidly in each succeeding year (\$42 million plus \$12 million in swing reductions in 1955-56). It is likely, however, that some of the current payments will be postponed (see Section IB) and the burden in 1955-56 and following years would be increased correspondingly. If further grant aid were considered undesirable or impossible but the West still wanted to support the Yugoslav economy, this could be achieved by making long term loans. Yugoslav potential resources of raw materials and manpower are sufficient to permit the carrying of a sizeable debt service burden (say \$30 to \$50 million a year). As indicated in section IB, it is not the overall level of foreign indebtedness that is creating difficulties for the Yugoslav economy, but rather the uneven distribution of the servicing burden. If the loan program were coordinated in such a way as to avoid extremely large repayments in any one year, the loans could serve to cover at least part of any future Yugoslav deficits.

b. Private donations and private capital movements, which have accounted for \$20 to \$30 million each year from 1947 to 1952, represent the

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other type of foreign "assistance" other than grant aid. They bear much greater resemblance to grants than do the loans or credits, since donations do not have to be repaid in the future. However, grant aid is a stable quantity once it is decided upon, while private donations are outside of government control and cannot be depended upon to cover a deficit. There is no reason to assume that these movements would cease, but obviously, their future level cannot be predicted. If they should continue at roughly the same level, as in recent years, they would serve as a significant balancing factor in Yugoslav foreign accounts and together with loans, mentioned above, could cover a major portion of expected trade deficits, even including MDAP support needs.

3. Yugoslav Means of Adjusting Continuing Deficits Without Aid

As shown above, it is likely that Yugoslavia, following its present programs, will probably not be able to balance its foreign accounts without some kind of foreign assistance in the next two years. If that is true and foreign assistance in the form of grant aid or otherwise is not sufficient to cover the deficit, the Yugoslav Government would be forced to take certain measures to change its program. There are two types of measures that could be taken: those leading to a decrease in expenditures and those resulting in increased receipts.

a. Increase in Receipts

From the discussion in section b above it appears likely that an increase in exports over and above that assumed by the IBRD could not be expected to become the major element in eliminating a deficit in Yugoslav foreign transactions. Nevertheless, some efforts would undoubtedly be made to increase exports.

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(1) The prospects of increasing great exports of agricultural products above the level estimated by the IBRD are not too bright (see Annex IIC). However, if the balance of payments situation became desperate, the government would undoubtedly attempt to raise the level of these exports and might be at least partially successful in this attempt. This would be employed only as a last resort as it would the much desired prevent/increase in consumption levels.

If necessary, the government could reverse its policy of attempting to conserve its forest resources and could increase its timber exports in the short run at the expense of succeeding years (see Annex IIC).

(2) It is not likely that exports of industrial or mining products could be increased much beyond IBRD projections which already call for a 29 percent increase over 1951-52 levels. The young Yugoslav industry will have to compete with more efficient Western European industries that are already established in the world markets, and in many cases will not be in a competitive position vis-a-vis these industries. There is some possibility of increasing exports of metals and minerals slightly above IBRD estimates, as Yugoslavia is in a better competitive position in regard to these commodities than manufactured products.

b. Reduced Expenditures

If, as appears likely, Yugoslavia would find it very difficult to increase its exports considerably over the IBRD projections, the major part of an adjustment to a deficit in the trade balance would have to be met by a reduction in imports and other expenditures below the levels in the IBRD projection.

(1) Military expenditures. Judging by all past indications, the Yugoslav Government would be very hesitant to cut military expenditures drastically in order to lessen the drain on the country's domestic and foreign resources. In addition there will be the gradually rising need for imports for this sector to provide economic support for the military equipment supplied to Yugoslavia under the MDAP program. However, since a reduction of imports for any sector of the economy would have very serious results, it is quite possible that some savings would have to be made in military imports for MDAP support, if that was not supplied without charge by the US, in non-MDAP military imports if the necessity were great enough. Savings could be achieved by stretching out the build-up of war industries, postponing the purchase of spares and replacements until they become absolutely necessary, reducing the use of equipment in training to save fuel and extend the life of this equipment, etc. This type of economy might vitiate the success of the MDAP program in modernizing and strengthening the Yugoslav armed forces. Thus, it might not be in accord with Yugoslav Government plans or the aims of the MDAP program.

(2) Consumption Expenditures. The IBRD projection assumes no increase in the value of textile and leather imports in 1955-56 and a decrease of 40 percent in the value of food imports from 1951 levels in comparable prices, despite expected population growth; thus, it is not likely that great savings could be effected in further cutting imports of food and raw materials for the consumption goods industries. In addition, the government has promised to increase the standard of living of the

population (see section IIB for a detailed discussion of consumption), which appears to be no higher and possibly even lower than before the war according to information supplied by the Yugoslav Government itself in its approach to the US Embassy in June 1953. Despite all this, if the expected level of total imports had to be cut, it is probable that part of the decrease would be in food and raw materials imports for the consumer goods industries, as has been the case in the past.

(3) Investment Expenditures. There is probably some scope for further reduction in imports for the investment program. However, the IBRD projection already reduced these imports to one half of the level in the last few years, and it is not possible to eliminate these imports completely. It would be possible to reduce them even further only insofar as they might be limited to replacements for worn out or obsolescent equipment and no new investments were undertaken.

4. Consequences of Withdrawal of Aid

Barring one or more serious droughts like those in 1950 and 1952, the withdrawal of aid would not seem to endanger the long term stability of the Yugoslav economy. It would, however, require the Yugoslav Government to make some far reaching adjustments unless the deficit were reduced by supplying MDAP support needs free of charge, by postponment of loan repayments by new loans and private donations. If all of these failed to eliminate the deficit, only two measures would remain, both involving undesirable effects on the Yugoslav economy. One way to reduce the deficit would be to default temporarily or permanently on existing loans.

This would be undesirable in that it would threaten any future attempts by Yugoslavia to obtain loans. The other way would be to increase exports and cut imports for the military establishment, the investment program and personal consumption. As pointed out above little can be expected from further export increases. Small cuts could be made in imports for each one of these sectors without committing any serious damage to the Yugoslav economy, but if sizeable cuts had to be made the original purposes of Western aid to Yugoslavia might be vitiated in one or another important respect. A severe cut in imports for the defense establishments would defeat the original goals of the MDAP program in modernizing and strengthening part of the Yugoslav armed forces. A large reduction in imports for consumption would affect production incentives in industry and agriculture. Too deep a cut in imports for investment purposes would affect adversely the future growth of Yugoslav industrial production, and if imports for replacements were also restricted it could result in reduced industrial production. The cuts in imports for consumption and investment would have the secondary effect of restricting export availabilities of industrial and agricultural products, thus aggravating further the balance of payments situation.

There is no way of calculating in advance the point at which any of these potentially undesirable effects would materialize. This will become apparent only through careful appraisal of future Yugoslav economic developments, as they occur, in the light of the considerations underlying this study.